

In Transition

Topics In Transition Management

Volume 17 - Spring 2009

The question on the minds of most investors as the first quarter of 2009 drew to a close was: "Are we there yet?" Clearly, the "there" in mind was "The Bottom" as in the bottom of the hair-raising ride that has been the capital markets since late 2007. There certainly were auspicious signs, or in the words of US Federal Reserve Chairman Ben Bernanke, potential "green shoots"¹

For one thing, most equity markets managed to eke out a gain in March of 2009 with the S&P 500[®] closing up nearly 9% to mark its first month of significant gains since August of 2008. Particularly encouraging was the reversal in the closing weeks of the quarter as the index rose from a dozen year low of an ominous 666 in early March.

For the metrics that we track in this series (as shown below), there was clear improvement from the point of view of a client in transition.

Component Costs (in bps) of US Large Cap Equity Transitions

	31-Dec-08	31-Mar-09	Q/Q Δ	Directional
commissions*	7.00	7.90	0.9	↑ increase in component cost
bid/ask spreads**	9.7	9.18	-0.52	↓ decrease in component cost
volatility***	628	452	-176	↓ decrease in component cost

*Average commission in basis points for a U.S. large cap liquidation, based on S&P 500 constituents, at 2 cents per share commission

**Average daily spread of the S&P 500[®] constituents

***Average daily volatility of the S&P 500[®] constituents

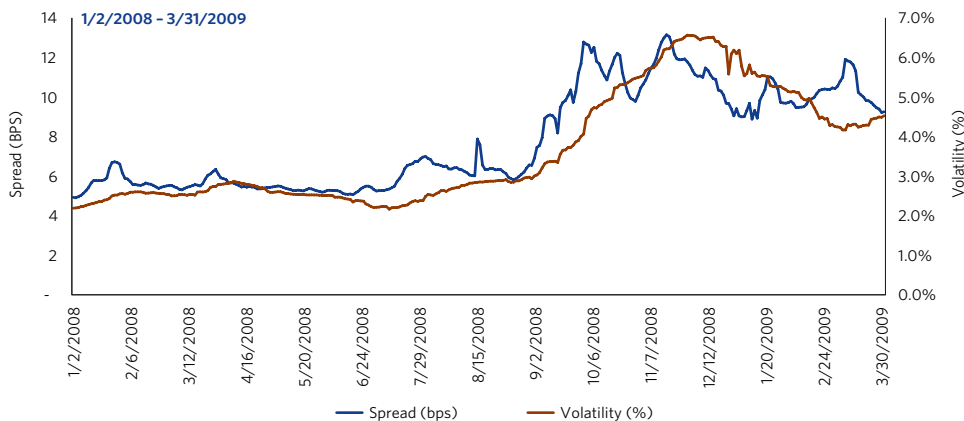
Data Source: ITG, 2009

The slight relative increase in commissions for a theoretical US Large Cap Equity transition was due to the 11% decline for the benchmark in the quarter. Because our calculation assumes a static share count quarter-over-quarter, lower portfolio values translate into higher relative costs. Even so, our other two observed parameters — spread and volatility — reversed trend. For these two component costs of transitions, March 2009 marked the first positive month since capital markets went into a death spiral in September of last year post-Lehman. This upturn looked improbable in January and February as broader markets remained under considerable pressure for most of the quarter.

¹In a interview with the CBS newsweekly "60 Minutes" on March 15, 2009, Chairman Bernanke indicated that, "We are seeing progress in the money market mutual funds, and in the business lending area. And I think as those green shoots begin to appear in different markets and as some confidence begins to come back that will begin the positive dynamic that brings our economy back."

Our measures of spread and volatility undulated across the quarter as depicted below.

Average Spread (BPS) and Average Volatility (%) of S&P 500® Constituents



Data Source: ITG, 2009

Spreads for the average US large cap stock peaked intra-quarter on March 10th while the current bear market low occurred on the 9th. Curiously, the low volatility reading for the period (4.14%) occurred the same day. Typically, spread and volatility tend to be positively correlated, and in retrospect, the divergence here may have been signaling the potential for the powerful rally that followed. For those of you keeping score at home, the spread low for the quarter was on the 15th of January at 8.9 bps while volatility formed a double-top for the period on January 6th and then again two days later at 6.19% for the typical stock in the benchmark. As we go to print, conditions continue to moderate with all three variables (commission, spread, and volatility) registering declines since the end of March.

For the first time in this series, we consider average transaction costs of various global asset classes by modeling hypothetical commissions, spreads, and market impact expected in the purchase of a USD 100 million portfolio for a given benchmark. The table below is based on an estimate (model) of what it would cost to purchase a \$100 million index portfolio based on a variety of indices. As of March 31, 2009, those estimates were as follows:

Estimated Simulated Average Trading Costs (In BPS) For Various Global Benchmarks, as of end of Q1 2009

INDEX*	COMMISSION	ESTIMATED BID/ASK SPREAD AND MARKET IMPACT	TAXES AND FEES	TOTAL TRANSACTION COSTS
MSCI ACWI ex US	7	42	3	52
MSCI EAFE	7	25	9.5	41.5
Emerging Markets	25	80	14	119
S&P 500	7.9	11	0	18.9
Russell 2000	9	60	0	69
Russell 3000	8	20	0	28
Wilshire 5000	8.4	40	0	48.4
Barclays Aggregate	0	300	0	300

*Hypothetical commission charges, for analytical purposes, are based on purchasing a \$100 million benchmark portfolio from cash. Any results presented based on simulated or hypothetical results have certain inherent limitations. Unlike actual results, any simulated or hypothetical results do not represent actual trading.

Taxes and fees vary depending on the specific equity securities being purchased.

Estimated spreads and market impact figures are loosely based on specific transition events performed in the first quarter.

Please see disclosures at right.

Data Source: MTM, 2009

While the above summary does not capture the volatility costs associated with transitions, it is intended to serve as a frame of reference for our readers. We will continue to track quarterly changes in transactions costs across various global benchmarks as this series continues and look forward to continuing to enhance this offering.

MTM offers global transition management services designed to assist clients rebalance asset allocations, enter new investment strategies, or liquidate existing portfolios. The Bank of New York Mellon has provided transition services to clients since 1983. Headquartered in San Francisco and with a global presence, MTM, as part of The Bank of New York Mellon, offers a proven process designed to mitigate operational risks, lower transaction costs and reduce the administrative burden for client sponsors.

Please feel free to contact us should you have any questions or desire additional information.

Jamie Cashman, CFA
(215) 553-4436
jamiec@mcm.com

Mark Dwyer
+44 20 7163 2544
mark.dwyer@bnymellon.com

John Egar
(416) 643-5137
johneg@mcm.com

David Hanlon
(617) 722-7229
davidjh@mcm.com

Pat Hughes, CFA
(415) 975-2331
patrickh@mcm.com

Certain brokerage services provided by MBSC Securities Corporation, member FINRA. The risks for each transition event vary according to client goals, strategy and market climate. There is no guarantee that losses or costs will not occur.

The statements and opinions expressed in this series are those of the authors and can change at any time without notice. The information in this series has been developed internally and/or/ obtained from sources MTM believes to be reliable; however, MTM does not guarantee the accuracy of completeness of such information. Any results presented based on simulated or hypothetical results have certain inherent limitations. Unlike actual results, any simulated or hypothetical results do not represent actual trading. Also, because trades have not actually been executed, simulated results may have under- or over-compensated for the impact, if any of certain market factors, such as lack of liquidity. Simulated or hypothetical programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve results similar to those being shown. This series should be construed as investments, legal or tax advice.